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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of)
)
Revisions to Price Cap)
Rules for AT&T Corp.) CC Docket No. 93-197

REPORT AND ORDER

Adopted: January 12, 1995

Released: January 12, 1995

By the Commission:

I. INTRODUCTION

1. In 1989, the Commission eliminated traditional rate of return regulation for AT&T Corp. ("AT&T") and implemented a system of price cap regulation.¹ The new regulatory regime creates incentives for AT&T to improve its efficiency and introduce innovative services, while reducing AT&T's incentive to shift costs from more to less competitive service offerings. Under this system, prices are capped rather than profits. Thus, the plan gives AT&T the incentive to earn higher profits by operating more efficiently, for example, by reducing its costs. To implement the price cap system, the Commission divided AT&T's services into three classifications called baskets and established a price cap index ("PCI") for each basket.² The PCI imposes a price ceiling for the services in that basket. In order for the Commission to determine whether rate levels exceed the PCI, AT&T must compute and file for each basket an actual price index ("API") that represents a weighted average of the actual prices of the services within the

¹ Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Notice of Proposed Rulemaking, 2 FCC Rcd 5208 (1987), Further Notice of Proposed Rulemaking, 3 FCC Rcd 3195 (1988) (Further Notice), Report and Order and Second Further Notice, 4 FCC Rcd 2873 (1989) (AT&T Price Cap Order), Erratum, 4 FCC Rcd 3379 (1989).

² The three baskets contain, respectively, (1) residential and small business services (Basket 1); (2) "800" number services (Basket 2); and (3) other business services (Basket 3). A number of AT&T services are excluded from price cap regulation. See 47 C.F.R. § 61.42(c) for a list of excluded services. For the most part, the Commission has deregulated the services in Baskets 2 and 3. See note 57, infra.

basket. AT&T may change rates for services within each basket if the weighted average of all prices remain below the cap, or PCI.³ The baskets are further subdivided into service categories, with bands for each service category. The rates for each service band are established by the service band index (SBI). The SBI limits the range within which AT&T may raise or lower prices for individual rate elements in the category each year and still receive streamlined tariff scrutiny. A presumption of lawfulness attaches to rate changes that are below the PCI and within their service categories' bands.⁴

2. An integral part of the price cap plan is a periodic review to determine whether the plan is functioning as we intended and in accordance with the Communications Act of 1934, as amended ("Act"). Accordingly, the Commission adopted a program that combined ongoing monitoring with a formal review of the price cap plan that would be completed during the fourth year. The review was to consist of a comprehensive examination of the effects of price cap regulation, one that considered all available measures of market and carrier performance, such as actual prices, achieved rate of return, quality of service and technological advances.⁵

3. The Commission undertook the first performance review of AT&T, as scheduled, in 1992.⁶ On July 23, 1993, the Commission issued a Report on AT&T's performance under price caps.⁷ Based on the record in the AT&T Performance Review, the Commission determined that, while overall the price cap plan for AT&T is achieving the goals it is designed to meet, some adjustments to the plan would enhance its effectiveness. Accordingly, the Commission initiated this proceeding to determine whether the price cap plan should be revised in four specific areas and also sought additional information from AT&T concerning its Equipment Blockage and Failure ("EB&F") Reports. These reports measure call blockages and failures for AT&T's services.⁸ Six parties filed comments or replies in this proceeding.⁹

³ Further Notice, 3 FCC Rcd at 3440.

⁴ AT&T Price Cap Order, 4 FCC Rcd at 3095.

⁵ Id. at 3143.

⁶ Price Cap Performance Review for AT&T, Notice of Inquiry, CC Docket No. 92-134, 7 FCC Rcd 5322 (1992) (Notice).

⁷ Report, CC Docket No. 92-134, 8 FCC Rcd 5165 (1993) (AT&T Performance Review).

⁸ Revisions to Price Cap Rules for AT&T, CC Docket No. 93-197, Notice of Proposed Rulemaking, 8 FCC Rcd 5205 (1993) (NPRM). See para. 42 *infra*, for further discussion of the EB&F Reports.

⁹ Comments were filed by AT&T, Sprint Communications Company LP (Sprint), Aeronautical Radio, Inc. (ARINC), WilTel, Inc. (WilTel), and the Competitive Telecommunications Association (CompTel). Reply comments were filed by AT&T, WilTel,

4. In the NPRM, the Commission set out the following four issues for comment: (1) whether to remove commercial services from Basket 1;¹⁰ (2) whether to revise the price cap treatment of the 800 directory assistance service remaining in Basket 2 and the analog private line services remaining in Basket 3; (3) whether to remove optional calling plans (OCPs) from Basket 1; and (4) whether to clarify or revise the required monitoring and reports of AT&T's service quality and network reliability, including its EB&F Report.

5. This Order removes commercial services from price cap regulation and initiates streamlined regulation for those services. We do not, however, remove either analog private line services or 800 directory assistance service from price cap regulation at this time. In addition, we defer a decision on OCPs to further proceedings in this docket and a related docket on AT&T's promotions (CC Docket No. 87-313). Finally, we find that AT&T has responded adequately to our questions concerning its EB&F Reports, and conclude that revisions to the procedures used by AT&T to compile the reports do not appear necessary at this time. We will continue to review the semi-annual EB&F Reports to ensure that they provide an accurate measure of AT&T's service quality and network reliability trends and performance.

II. COMMERCIAL SERVICES

A. The NPRM

6. The NPRM addressed AT&T's petition for waiver to remove commercial services from price caps. According to AT&T, adopting streamlined regulation for commercial services would complete the process of streamlining competitively-provided outbound commercial services that was begun in the Interexchange Proceeding.¹¹ Several parties commenting on AT&T's waiver request question the market data upon which AT&T relied to support its position. In the NPRM, the Commission stated that adopting AT&T's request to streamline commercial services

Sprint, Pacific Bell and Nevada Bell (Pacific Companies), and the staff of the Bureau of Economics of the Federal Trade Commission (FTC). The Bureau of Economics of the FTC also filed a motion for leave to file reply comments out of time. The pleading states that the views contained in the pleading are that of a staff member of the Bureau of Economics and do not represent the views of the full FTC. We will grant the motion and accept the reply comments.

¹⁰ AT&T first raised the issue of whether to remove commercial services from price caps in a petition for waiver filed on September 1, 1992. The Commission decided to ask for comment on the issues raised by that petition in this proceeding. See AT&T Performance Review, 8 FCC Rcd at 5166 n.9.

¹¹ Competition in the Interexchange Marketplace, Notice of Proposed Rulemaking, 5 FCC Rcd 2627 (1990) (NPRM), Report and Order, 6 FCC Rcd 5880, 5908 (1991) (Interexchange Proceeding), recon., 6 FCC Rcd 7569 (1991), further recon., 7 FCC Rcd 2677 (1992), Second Report and Order, 8 FCC Rcd 3668 (1993), recon., 8 FCC Rcd 5046 (1993).

could encourage competition in this market, while continued price cap regulation might inhibit such competition. The Commission noted, however, that AT&T's market data may not justify the relief that AT&T has requested.

7. Accordingly, the Commission raised a number of issues that it intended to consider in determining whether to remove commercial services from price caps. The Commission questioned whether AT&T properly identified commercial services as a class of service distinct from residential services. The Commission also expressed concern that AT&T might offer new and restructured services only to its business customers. The Commission stated that AT&T's proposed classification of commercial services does not make clear whether it would bar resale of services designated as commercial to residential customers. Finally, the Commission asked for comment on how streamlining tariff review on rates for commercial long distance services would affect the rate levels and structure for these services.

B. Comments

8. In its comments in response to the NPRM, AT&T argues that it is appropriate to classify commercial service as a separate class of service and price it accordingly. AT&T notes that Section 201(b) of the Act expressly provides for a separate "commercial" service classification.¹² AT&T also contends that the Commission's Rules provide for a commercial service classification, citing, for example, the fact that Sections 69.104(g) and (h) of the Commission's Rules establish separate end user common line charges for residential and multi-line business subscribers.¹³ AT&T defines commercial long distance services as domestic and international "Dial Station calls originated on a line for which the subscriber pays a rate that is described as a business or commercial rate in the applicable local exchange service tariff for switched services."¹⁴

9. In addition, AT&T states that in July and August 1992, it filed tariff revisions to create separate commercial and residential basic schedules in Basket 1. Those tariffs did not change any rate levels and became effective without opposition in September 1992. The first permanent rate changes differentiating commercial and residential rates were filed in March 1993, and took effect, again without opposition, on July 1, 1993.¹⁵

10. In response to the Commission's concerns regarding the possible introduction of restrictions on resale, AT&T asserts that it will not restrict the use or resale of commercial long distance service. According to AT&T, a commercial AT&T customer remains free under the

¹² 47 U.S.C. § 201(b); AT&T Comments at 14.

¹³ 47 C.F.R. § 69.104 (g), (h); AT&T Comments at 16.

¹⁴ Id. at 13, citing AT&T Tariff F.C.C. No. 1, Section 6.20.

¹⁵ Id. at 12.

tariff to resell commercial long distance service. AT&T further states that rates for its commercial long distance service will be determined by market forces after commercial services are streamlined and that it cannot speculate on what those charges will be in the future.

11. WilTel, CompTel, and Sprint oppose removing commercial services from price caps. Sprint contends that AT&T's market share has not changed sufficiently to warrant removing commercial services from price caps. WilTel, a small interexchange carrier, is concerned that AT&T will engage in unreasonable pricing practices if its commercial services are moved out of price caps.¹⁶ WilTel asserts that AT&T continues to have a major share of the interexchange market and that competition has not developed in the long distance market. As a result, WilTel contends that AT&T's services should continue to be regulated under price caps to prevent AT&T from engaging in unreasonable pricing practices.¹⁷

12. CompTel opposes removal of commercial services from price caps for a number of reasons. It claims that AT&T's market share is essentially the same now as it was several years ago when the Commission concluded in the Interexchange Proceeding that AT&T's commercial services should remain in Basket 1.¹⁸ CompTel states that commercial services should not be streamlined because removing regulatory restraints on AT&T's prices would neither be beneficial to consumers nor encourage competition in the long distance market. According to CompTel, AT&T would be able to offset any rate decreases implemented for its competitive commercial services with rate increases for its less competitive residential MTS services.¹⁹

13. In its reply, AT&T disputes the commenters' claims that the Commission found in the Interexchange Proceeding that the level of competition for Basket 1 services did not warrant streamlined regulation. According to AT&T, in that Order the Commission deferred a decision on whether these services should be streamlined because there were "unresolved issues and insufficient information" about the competitiveness of Basket 1 services.²⁰ Moreover, AT&T contends, the Commission made no specific findings about commercial services in that proceeding because the classification did not exist at that time. AT&T also asserts that the Commission's analysis of competition in the interexchange market was based on data from 1989. AT&T claims that, contrary to the contentions of the opposing parties, there have been significant changes in the market since that time. AT&T maintains that the market analyses submitted by AT&T in this proceeding demonstrate that its share of the commercial long distance market, as

¹⁶ WilTel Comments at 3.

¹⁷ Id. at 2-3.

¹⁸ CompTel Comments at 2, citing Interexchange Proceeding, 6 FCC Rcd at 5908.

¹⁹ Id. at 4-5.

²⁰ AT&T Reply, citing Interexchange Proceeding, 6 FCC Rcd at 5908.

measured by minutes of use, has fallen by 15 percentage points since 1989. AT&T asserts that no party submitted reliable, empirical data in this proceeding to refute this showing. AT&T also states that the record in this proceeding shows that its share of the combined commercial long distance and small business optional calling plan customer base decreased by 24 percentage points, as measured by minutes of use, since 1989.²¹ Finally, AT&T asserts that it will not restrict the use or resale of commercial long distance service.²²

14. WilTel argues in its reply that AT&T should not be permitted to create a commercial class of service because that will enable AT&T to segment the interexchange market between residential and commercial customers. It contends that this market segmentation will allow AT&T to raise prices for its less competitive MTS services while lowering prices for its relatively more competitive commercial services.²³ Sprint contends that AT&T provides no support for its claim that it no longer possesses market power in the provision of commercial services that would warrant streamlining that service.²⁴

C. Discussion

1. Introduction

15. The commercial services classification was created by AT&T pursuant to Section 201(b) of the Communications Act, which permits the creation of specific classifications of services, including commercial. Commercial services refers to services used by AT&T's customers who are classified as business or commercial customers by local telephone companies. We find that these services should be removed from price cap regulation.

16. AT&T demonstrates both in its comments and through additional information submitted in the record of this proceeding that there is sufficient evidence to conclude that AT&T's commercial long distance services are subject to substantial competition. As discussed more fully below, our analysis rests on considerations of market share, demand responsiveness and supply responsiveness. As a result of this analysis, we conclude that AT&T lacks the ability to exercise unilateral market power in the provision of these services and that there is sufficient competition among providers to justify moving AT&T's commercial services from price caps to streamlined regulation.

²¹ AT&T Comments at 21.

²² AT&T Reply at 5-7.

²³ WilTel Reply at 4. The Pacific Companies, in their reply, made general comments opposing any changes to price cap regulation for AT&T until the interexchange market is truly competitive.

²⁴ Sprint Reply at 1.

2. Market Share and Concentration

17. As evidence of its lack of market power, AT&T claims that its share of the overall minutes of use of commercial long distance services decreased from 54 percent in 1987 to 39 percent in 1991.²⁵ By 1993, however, AT&T's market share increased somewhat to 44 percent.²⁶ No party has offered any data to rebut these figures.

18. The slight increase in AT&T's market share does not preclude us from finding that AT&T does not possess market power. In the Interexchange Proceeding, we found that AT&T's 50 percent share of the Basket 3 business services market was "a level that is not incompatible with a highly competitive market" and, hence, does not by itself demonstrate that a firm possesses market power.²⁷ Here, AT&T's market share is even lower. Moreover, the fluctuation in AT&T's market share indicates the considerable willingness of commercial long distance customers to shift between long-distance service providers. This is further evidence that AT&T lacks unilateral market power. In comparison to AT&T's 44 percent share, MCI Telecommunications Corporation's (MCI) share of this market in 1993 was 21 percent, Sprint's share was 13 percent and all other long distance providers had a combined market share of 20 percent.²⁸ The size of the competitors relative to AT&T suggests they have capacity to service a significant portion of AT&T's customers, should these customers desire to switch carriers. Our analysis of the carriers' capacity, discussed below, further supports this finding.

19. Market share is only one factor to be considered in determining the level of competition in a given market. Relying solely on AT&T's market share at a given point in time to make this determination would be too static and one dimensional. While we have considered market share data in our determination, it has been considered in conjunction with other important factors, as described below.²⁹

²⁵ AT&T Reply at 6, citing AT&T Petition for Waiver of Price Cap Regulations for New Commercial Long Distance Service Classification at 14-15.

²⁶ In the NPRM, the Commission stated that whether or not resellers were included in the computation of market share data would not alter the amount of AT&T's market share. CompTel raises this argument again in its comments in response to the NPRM. CompTel Comments at 3. AT&T states in its comments that resellers are not included in market shares of the carriers whose services are resold. AT&T Comments at 19.

²⁷ Interexchange Proceeding, 6 FCC Rcd at 5890 (footnote omitted).

²⁸ Ex parte from E.E. Estey, AT&T, to Secretary, FCC, dated July 22, 1994.

²⁹ This is consistent with the approach we have followed in prior proceedings. See, e.g., Interexchange Proceeding, 6 FCC Rcd at 5887-90.

3. Demand Responsiveness of AT&T Customers

20. Demand responsiveness is the propensity of AT&T's customers to switch carriers or otherwise change the amount of services they purchase from AT&T in response to relative changes in price and quality. AT&T presents evidence that commercial customers will switch carriers in order to obtain price savings and desired features. According to AT&T, its principal competitors provide a number of services that are comparable to those offered by AT&T. For example, Allnet's Solution I and II, Pacesetter and Pacesetter Plus, Cable and Wireless' Longer Distance and Focus, Focus II and Focus III, MCI's Prism Plus, Preferred and Friends of the Firm and Sprint's The Most for Business and Clarity are all alternative commercial long distance services.³⁰

21. Moreover, there are indications that customers are well aware of, and make use of, these alternative suppliers.³¹ For example, AT&T submitted a chart showing that between April and July of 1994, 150,000 AT&T commercial customers per month switched either from AT&T to another long distance provider or from another provider to AT&T.³² If this level of customer churn continued over a year, it would amount to approximately 1.8 million customers switching either to or from AT&T out of a customer base of approximately eight million AT&T commercial long distance customers.³³ This amounts to approximately a 23 percent annual churn in AT&T's total customer base of commercial long distance customers, which is strong support for the argument that AT&T lacks market power over its customers. The evidence of customer churn -- that customers are significantly sensitive to price and quality changes -- is corroborated by the fluctuations in AT&T's market share described above. These factors buttress our conclusions that AT&T cannot exercise unilateral market power in the provision of commercial long distance services and that AT&T's commercial services should be removed from price caps and subjected to streamlined regulation.

4. Supply Responsiveness of AT&T's Competitors

22. Another important factor that we believe is indicative of the level of competition in the interstate long distance market is the apparently high elasticity of supply of AT&T's competitors. Supply elasticity refers to the ability of competitors in a market to meet additional demand. In the long distance market, supply elasticity depends to a large extent on the capacity

³⁰ Ex parte from E.E. Estey, AT&T, to Secretary, FCC, dated July 25, 1994.

³¹ Id.

³² Id. See also FTC Bureau of Economics Staff Reply at 17-8, that concurred with the Commission's findings in the Interexchange Proceeding that the commercial long distance market exhibits high demand elasticity and that customers will switch carriers in order to obtain pricing savings and desired features.

³³ Ex parte from James Spurlock, AT&T, to Secretary, FCC, dated December 30, 1994.

of the networks of AT&T's competitors. Even if one company has a high market share, it will be constrained from raising its price if its customers are willing to switch providers and its competitors are willing and able to serve those customers at current price levels.³⁴ We note that competitors must be willing and able to serve a significant portion of AT&T's commercial long distance traffic in response to a price increase, but by no means all of its traffic, in order to deter a price increase.³⁵

23. In the Interexchange Proceeding, we noted the impact that excess capacity has on the interstate telecommunications market because it enables firms with relatively small market shares to be well-positioned to capture large numbers of their competitors' customers if their competitors chose to price above competitive rates.³⁶ AT&T's competitors appear to have sufficient network capacity to serve a significant portion of AT&T's commercial long distance traffic. Much of the network capacity owned by the long distance carriers is fiber optic technology, which is capable of expansion to serve increasingly larger amounts of traffic at relatively low cost. In 1993, AT&T owned 47 percent of the total fiber miles while serving 60 percent of the minutes of use of the interexchange market. In contrast, all other interexchange carriers owned 53 percent of the total-fiber miles while serving 40 percent of the interexchange market. It therefore appears that AT&T's competitors have a greater supply of unused fiber capacity than AT&T.

24. In addition, it appears that the interexchange carriers' network expansion has kept pace with the growth in the market. Our report on 1993 fiber deployment indicates that all major interexchange carriers have expanded their facilities and appear ready to provide service to additional customers. The total number of fiber-miles owned by all interexchange carriers at the end of 1993 was 2,547.5 million miles.³⁷ Between 1990 and 1993, AT&T increased its fiber miles from 935,700 to approximately 1.2 million miles, MCI increased its fiber miles from 388,000 to 555,500 and Sprint increased its fiber miles from 453,400 to 467,200.³⁸

25. The relative size of potential demand compared to available supply is another important indicator of whether AT&T's competitors have sufficient capacity to serve customers that wish to switch from AT&T to another carrier. In 1993, AT&T had 3.16 billion commercial long distance minutes of use. In the same year, its competitors had approximately 73.8 billion

³⁴ Interexchange Proceeding, 6 FCC Rcd at 5888.

³⁵ Id. The Commission made a similar finding with respect to AT&T's competitors' ability to absorb its Basket 3 business services.

³⁶ Id.

³⁷ FCC Report: Fiber Deployment Update-End of Year 1993, Table 2, released May 13, 1994 (FCC Report).

³⁸ Id.

switched minutes of use. AT&T's commercial long distance minutes, therefore, represented only 4.3 percent of the total switched minutes of use of all other carriers. From these numbers, it is evident that AT&T's commercial long distance traffic represents a small portion of the overall switched traffic and that other carriers could absorb all of AT&T's traffic.³⁹ We find that the amount of capacity held by the various long distance carriers is so high as to reduce greatly the probability of sustained monopoly pricing by any one participant.

5. Conclusion

26. We find that there are adequate competitive alternatives to AT&T's commercial long distance services to constrain AT&T's exercise of monopoly power for these services. We recognize that there is a potential problem that the largest interexchange carriers might engage in oligopolistic coordination resulting in prices above competitive levels in this market.⁴⁰ We believe, however, that several factors will operate to deter such a result. As discussed above, because the networks of the interexchange carriers have significant capacity, the cost of serving additional traffic is very low and, conversely, the cost savings associated with a traffic reduction are also quite low. Thus, these carriers have great incentive to protect their substantial investment in these facilities by keeping their prices low to attract and keep customers. Also, the possibility of oligopolistic coordination to raise prices is limited by the demonstrated willingness and ability of commercial long distance customers to move among various commercial long distance services offered by the numerous interexchange carriers.

27. We believe that moving commercial services into the category of services subject to streamlined regulation should encourage more vigorous competition for these services. As we noted in the Interexchange Proceeding, price cap regulation imposes costs on consumers to the extent it denies AT&T the pricing flexibility it needs to react to market conditions and customer demands.⁴¹ We also find that the Commission's rationale in that proceeding for instituting streamlined regulation for business services in Basket 3 is applicable here. The Commission concluded in that decision that "permitting business service tariffs to go into effect on fourteen days notice will result in a substantially more dynamic and proactive market without presenting an undue risk of undetected and unremedied anticompetitive action."⁴² We also note that permitting AT&T to offer these services under streamlined regulation will enable AT&T to enter into contracts with customers for these services. We found in the Interexchange Proceeding that "[o]ne important benefit of contract carriage is that it will increase the ability of customers to

³⁹ FCC Report at Chart 2.

⁴⁰ In an oligopolistic market, there are so few participants that the action of any one of them will materially affect price and have a significant impact upon competitors.

⁴¹ Interexchange Proceeding, 6 FCC Rcd at 5895.

⁴² Interexchange Proceeding, 6 FCC Rcd at 5895 (footnote omitted).

negotiate service arrangements that best address their particular needs."⁴³ By increasing the number of pricing options, contract carriage also reduces the likelihood of oligopolistic coordination.

28. In addition, protection to ratepayers is afforded by the fact that tariffs for commercial long distance service remain subject to Title II of the Communications Act. If the Commission finds that any tariff filing by the interexchange carriers conflicts with the Act or the Commission's Rules, the filing can be rejected on that basis or suspended and investigated pursuant to Section 204 of the Communications Act.⁴⁴

29. Accordingly, we will remove commercial long distance services from Basket 1 effective thirty days after publication of this Order in the Federal Register. We also will require AT&T to remove revenues associated with commercial long distance services from the revenue base used to calculate the various price cap indexes (API and SBIs) in Basket 1 from that date forward.

30. Under our rules, removal of services and their associated revenues from Basket 1, by itself, does not cause any of the various indexes to change.⁴⁵ This is because AT&T is only required to update the PCI as either part of the annual price cap filing or to reflect the effect of midyear access and exogenous cost changes. Also, AT&T is only required to update the API and relevant SBIs in connection with price cap tariff filings proposing rate changes. This Order does not require any such rate changes to be made. When AT&T files a rate change after the effective date of this Order, however, the rate change will affect the indexes differently than would have been the case if AT&T's commercial long distance services had not been removed from Basket 1. This is because the API and SBI formulas require that the price indexes be calculated, in part, by multiplying filed rate changes by their base period revenue weights. With the removal of commercial long distance services as required by this Order, the base period revenue weights of services remaining in Basket 1 will change.⁴⁶

31. While we conclude that commercial services should be removed from price caps, we will not permit AT&T to place restrictions on the use and resale of commercial services. The

⁴³ Id. at 5899.

⁴⁴ 47 U.S.C. § 204. See Interexchange Proceeding, 6 FCC Rcd at 5894 & n.121 (presumption of lawfulness under streamlining does not change the substantive standard to be used in evaluating a tariff in a complaint proceeding or tariff investigation).

⁴⁵ See Sections 61.46 and 61.47 of the Commission Rules, 47 C.F.R. §§ 61.46 and 61.47 for a description of the formulas used for calculating the API and SBI, respectively.

⁴⁶ See Section 61.46 (a) of the Commission Rules, 47 C.F.R. § 61.46 (a) for a description of revenue weights.

Commission has a long-standing policy of prohibiting restrictions on resale of services.⁴⁷ If we see evidence of such restrictions, we will take rigorous enforcement action.⁴⁸

III. PRODUCTIVITY OFFSET

32. When it adopted price cap regulation for AT&T, the Commission included in the price cap formula a productivity offset, which measures the amount by which overall inflation for the economy has exceeded changes in AT&T's rates, to ensure that carrier productivity results in lower prices for telecommunications services.⁴⁹ The Commission found that productivity in the telephone industry has on average exceeded that of the overall economy by 2.5 percent per year. Nevertheless, because the Commission intended that ratepayers should benefit from the adoption of price caps and should share in the additional efficiency gains produced by carriers as a result of the new regulatory regime, the Commission decided that the productivity offset should be set at a level that exceeded the industry's historical productivity offset level. Accordingly, the Commission added a 0.5 percent "Consumer Productivity Dividend" to the historical productivity offset level to ensure that AT&T customers benefited from productivity gains expected under price cap regulation.

33. In the AT&T Performance Review, the Commission declined to revise the 3 percent productivity offset that applies, after adjustments for inflation and exogenous costs,⁵⁰ to each of AT&T's price cap baskets.⁵¹ AT&T now seeks to reopen this issue.⁵² It maintains that the productivity offset is no longer needed to protect consumers against excessive earnings from

⁴⁷ Regulatory Policies Concerning Resale and Shared Use of Common Carrier Services and Facilities, 60 FCC 2d 261 (1976), modified on recon., 62 FCC 2d 588 (1977), aff'd, AT&T v. FCC, 572 F.2d 17 (2d Cir.), cert. den., 439 U.S. 875 (1978). We recognize that there are a number of pending complaints that raise allegations that AT&T is placing restrictions on the resale of its commercial services. We will address those allegations within the context of the complaint proceedings.

⁴⁸ The Commission recently exercised its enforcement authority by issuing a Notice of Apparent Liability for Forfeiture and Order to Show Cause against AT&T for its failure to provide communications service under Contract Tariff 383. AT&T Communications, Apparent Liability for Forfeiture and Order to Show Cause, FCC 94-359, released January 4, 1995.

⁴⁹ AT&T Price Cap Order, 4 FCC Rcd at 2989.

⁵⁰ Exogenous costs are costs that change due to changes in laws, regulations, rules, or other administrative, legislative, or judicial decisions beyond a carrier's control and are not reflected by the inflation adjustment. Id. at 3002.

⁵¹ AT&T Performance Review, 8 FCC Rcd at 5168.

⁵² AT&T Comments at 7-10.

AT&T's Basket 1 services because prices have remained low for the first three years of price cap regulation.⁵³ AT&T also asserts that there is no reason to believe that the productivity factor, which is currently used for all of AT&T's interstate services, is the correct measure of productivity for the basic schedule switched residential services that will remain in Basket 1 if commercial services are removed. AT&T reasons that the Commission has two options: either compute a new productivity factor based on the revised composition of Basket 1 or eliminate the productivity factor. AT&T supports the elimination of the productivity factor.⁵⁴

34. AT&T has not substantiated its contentions that the Basket 1 productivity factor must be recomputed or eliminated if commercial services are removed from the basket.⁵⁵ Removing commercial services from the basket gives AT&T greater flexibility in setting rates for those services, while reducing its regulatory costs. If anything, those changes should enable AT&T to increase its productivity for what to date have been Basket 1 services. AT&T also asserts that it incurs different, often higher costs to provide commercial services. We believe that removal of these costs from the basket should make it easier for AT&T to meet the productivity factor for the services that remain.⁵⁶

35. AT&T has not submitted any information to demonstrate that the productivity factor that has been consistently applied to all Basket 1 services should be modified as a result of our removing commercial services from Basket 1. It has not provided, for example, cost data (other than the generally higher costs it claims for commercial services), or other information that demonstrate that it cannot continue to match or exceed the 3 percent productivity gains in providing basic schedule services. AT&T, of course, has sole access to the information that would support such a finding. On the present record, we find no substantial evidence that would justify modification or elimination of the 3 percent productivity factor for the services remaining in Basket 1. Should the Commission make other major changes to the composition of Basket 1, we will consider whether modification of the productivity factor is warranted at that time.

⁵³ Id. at 9 & n.20.

⁵⁴ Id. at 8-10.

⁵⁵ Id.

⁵⁶ Id. at 16 n.33.

IV. ANALOG PRIVATE LINE AND 800 DIRECTORY ASSISTANCE SERVICES

A. The NPRM

36. Basket 2 now contains only 800 directory assistance service, while Basket 3 contains only analog private line service.⁵⁷ The Commission sought comment on whether regulation of those baskets should be changed. In particular, the Commission sought comment on whether 800 directory assistance and analog private line services should be removed from price cap regulation. These services generate relatively low revenues when compared to AT&T's total interstate operations or the services originally included in Baskets 2 and 3. Therefore, the Commission noted that application of the usual price cap index calculations to these baskets may not be in the public interest. For example, the Commission suggested that the 3 percent productivity factor, which is used for all price cap calculations, may not be appropriate for a basket that contains only one service.⁵⁸

B. Comments

37. AT&T argues that the Commission should no longer apply the price cap productivity factor to the remaining services in Baskets 2 and 3. According to AT&T, the price cap productivity factor, based on historic, total interstate productivity improvements, has no logical relationship to the productivity improvements that can be expected for the Basket 2 and 3 services.⁵⁹ AT&T states that the analog private line services remaining in Basket 3 are being replaced by digital services. AT&T further contends that the 800 directory assistance service is unlike any of the communications services on which we based the productivity factor because it provides information, not transport of communications between end users. AT&T opposes the Commission's alternative proposal to combine Baskets 2 and 3 into a single basket. AT&T sees no benefit in continued price cap regulation of these services either in separate baskets or in one basket.⁶⁰

⁵⁷ Basket 2 originally contained all 800 services. Basket 3 was established for large business customers and contained the following services: Pro America I, II, and III; WATS; Megacom; SDN; other switched; voice grade private line and lines of a lower quality not suitable for voice and data transmission; and other private line services, such as analog private line offerings, which include analog voice grade private line and terrestrial television transmission services. AT&T Price Cap Order, 4 FCC Rcd at 3064. In 1991, the Commission streamlined all of AT&T's Basket 2 services except 800 Directory Assistance and all of its Basket 3 services except for analog private line services. Interexchange Proceeding, 6 FCC Rcd at 5893-95, 5905.

⁵⁸ NPRM, 8 FCC Rcd at 5208.

⁵⁹ AT&T Comments at 24.

⁶⁰ Id. at 25.

38. ARINC, an association representing airline carriers that make extensive use of analog private line services, opposes the removal of these services from price cap regulation. ARINC contends that after the Commission removed all but analog services from Basket 3,⁶¹ AT&T raised the rates for analog services dramatically. ARINC contends that consumers need the protection afforded by price cap regulation to prevent AT&T from increasing rates for analog private line services and to prevent cross-subsidization. ARINC recommends that the Commission place each rate element in AT&T's analog private line tariff in a separate service category and permit AT&T to raise or lower prices for each element no more than 5 percent per year to prevent further price increases by AT&T.⁶² No party filed comments concerning 800 directory assistance service.

C. Discussion

39. We decline to make any changes in Baskets 2 and 3. In the Interexchange Proceeding, we stated that we would not make any changes to 800 services in Basket 2 until 800 number portability became generally available.⁶³ 800 numbers became portable on May 1, 1993 with the implementation of a "data base" system of 800 access⁶⁴ and shortly thereafter the Commission removed 800 services from Basket 2, with the exception of 800 directory assistance. The Commission stated that because 800 number portability would not enable competing providers to offer 800 directory assistance, AT&T would continue to be the sole provider of this service. Accordingly, the Commission retained 800 directory assistance in Basket 2, but removed service bands and recalibrated the PCI and API for Basket 2 to reflect the elimination of all services other than 800 directory assistance from the basket.⁶⁵ 800 directory assistance remains a monopoly service and therefore it is necessary to regulate the price for this service to protect consumers. The current system of price cap regulation has been shown to be an effective method

⁶¹ See Interexchange Proceeding, 6 FCC Rcd. at 5895-96.

⁶² ARINC Comments at 3-4. ARINC filed a petition for reconsideration and clarification of the portion of the Report and Order in the Interexchange Proceeding that dealt with regulation of analog private line services under price caps. This Report and Order addresses the issues raised by ARINC in its petition and, accordingly, its petition is moot. The reconsideration orders in the Interexchange Proceeding, cited in note 11, supra, do not address the issue of regulation of analog private line services.

⁶³ Interexchange Proceeding, 6 FCC Rcd at 5906 & n.233.

⁶⁴ Provision of Access for 800 Service, Report and Order, 4 FCC Rcd 2824 (1989), recon., 6 FCC Rcd 5421 (1991), Second Report and Order, 8 FCC Rcd 907 (1993), further recon., 8 FCC Rcd 1038 (1993).

⁶⁵ See Interexchange Proceeding, Second Report and Order, 8 FCC Rcd at 3671, for a discussion of the adjustments made to the price cap rules for Basket 2 services because 800 directory assistance is the only service remaining in that basket.

for maintaining rates at reasonable levels. As noted in paragraph 1, supra, this regulatory regime caps AT&T's prices instead of its profits. We conclude that the rates for 800 directory assistance should continue to be subject to this regulatory scheme in order to protect captive customers of that service against unreasonable prices. We also find that the lack of competition for these two services lowers the costs associated with price cap regulation and further supports our decision to keep them in price caps at this time.

40. The record in this proceeding indicates that analog private line service offerings will continue to disappear. As we noted in the Report and Orders issued in both the Interexchange Proceeding⁶⁶ and the AT&T Performance Review,⁶⁷ analog private line customers are migrating to digital and virtual private line services. The Commission declined in the Interexchange Proceeding to remove analog private line services from price caps because:

elimination of the price cap restraints for analog private line service could lead to higher prices for these services. While many customers would likely respond to higher prices by switching to digital service, adequate substitutes using digital technology are not currently available to all users of analog private line services.⁶⁸

The Commission concluded that the market for these services was not as competitive as the markets for other services offered by AT&T, and therefore required continued oversight under price caps. None of the parties has presented any evidence that the situation has changed since the Commission's 1991 decision in the Interexchange Proceeding.

41. In addition, we deny AT&T's request that we no longer apply the productivity factor to the analog private line services in Basket 3 or to the 800 directory assistance services in Basket 2. In the Interexchange Proceeding, we declined to eliminate the productivity factor when we removed all services except analog private line services from Basket 3. We found that the small demand for these services did not justify the administrative expense of establishing a new productivity factor. In addition, we concluded that "we have no reason to believe that AT&T will not be able to meet the productivity goal embedded in the PCI."⁶⁹ AT&T has presented no new evidence in this proceeding that would require us to modify our prior conclusions. Nor has it provided any data to support adopting an alternative productivity factor. Therefore, there is no reason to revise our current regulatory protections for customers or remove them from Basket 3 at this time. Furthermore, AT&T has provided no evidence that the current productivity factor results in unreasonable 800 directory assistance rates. Therefore, 800

⁶⁶ Interexchange Proceeding, 6 FCC Rcd at 5893.

⁶⁷ AT&T Performance Review, 8 FCC Rcd at 5170.

⁶⁸ Interexchange Proceeding, 6 FCC Rcd at 5895.

⁶⁹ Id. at 5896 n.133.

directory assistance services will remain in Basket 2 until directory services are available from other suppliers, or AT&T proposes a more effective regulatory approach.

V. MONITORING OF SERVICE QUALITY AND NETWORK RELIABILITY

A. The NPRM

42. In the NPRM, the Commission addressed a number of issues relating to its monitoring of AT&T's service quality that have arisen since the NOI was issued in the AT&T Performance Review in 1992.⁷⁰ The Commission expressed concern that price cap regulation might create undesirable incentives for AT&T to permit the quality of its service offerings to deteriorate. As a result of this concern, the Commission required AT&T to file semi-annual EB&F Reports that track its performance in relation to an index that measures the frequency of call blocking. Call blocking occurs when calls are not completed due to equipment failures. The index for the EB&F Reports was set initially at 100, which established the baseline for comparison with any future deviations in service quality. The base period to be used for future comparisons was defined to be the first six months of 1989, which was the six-month period that immediately preceded the effective date of AT&T's initial price caps tariff. The EB&F Reports documented the blocking rate for successive six-month periods. The EB&F index is related positively to the blocking rate. That is, if the index exceeds 100, it means that a higher percentage of calls were blocked during the reporting period than were blocked during the base period. For example, a ten-point increase in the index would mean that 10 percent more calls were blocked during the reporting period than during the base period. The figures are reported separately for blockage associated with AT&T's network and blockage caused by all factors, including blockage attributable to the facilities of local exchange companies terminating AT&T long distance calls.⁷¹

43. In 1992, AT&T made certain corrections to the 1989 base period, the blockage data that provided the reference point for all subsequent index calculations. It informed the Commission of this change by letter in January 1993.⁷² AT&T concluded that these corrections were necessary to compensate for a computer programming error it had discovered in the pre-price cap baseline data used to set the index. AT&T found that improperly programmed switches had caused a number of the calls to be erroneously classified as EB&F calls when they should

⁷⁰ NOI, 7 FCC Rcd at 5323.

⁷¹ Id. at 5325.

⁷² Letter from P.J. Aduskevicz, AT&T, to Chief, Industry Analysis Division, FCC, dated January 26, 1993.

have been classified as completed calls.⁷³ Because of this programming error, AT&T contends, data for the first three months of the pre-price cap period were incorrect and could not be reconstructed. No accurate data had been collected and there was no means to recalculate how many of the calls made during that time were completed. Therefore, AT&T recomputed the index using data from the last three months of the pre-price cap period, which AT&T asserts are correct. AT&T's EB&F scores improved under the revised index.⁷⁴

44. In 1992, AT&T also informed the Commission that starting with its report for the first six months of 1993, it began to use a new method of computing EB&F. Before the Commission required the public submission of EB&F rates, AT&T had included calls to Canada and the Caribbean within its domestic calling measurements for its own internal purposes. In January 1993, AT&T began to exclude calls to and from Canada and the Caribbean, except for the U.S. Virgin Islands and Puerto Rico, from its internal calculations in order to evaluate domestic call characteristics more accurately. AT&T stated that these changes make comparisons with earlier reporting periods impossible. As a result of this change, AT&T has adjusted its domestic EB&F monitoring system to exclude calls to Canada and parts of the Caribbean to reflect the actual domestic calling patterns. AT&T contends that these changes will not interfere with the Commission's ability to identify trends in the level of AT&T's service quality and network reliability.⁷⁵

45. In the NPRM, the Commission stated that these changes to AT&T's EB&F Reports raised concerns about the effectiveness of the reports as a tool for monitoring AT&T's service quality and network reliability under price caps, the very reason for requiring the reports. As a result, the Commission ordered AT&T to commission and submit an independent audit of all EB&F data. The audit report and the audited EB&F data series were to be submitted as part of AT&T's initial comments in this proceeding. The Commission also requested comment on whether its service quality and network reliability monitoring requirements for AT&T should be revised or clarified.⁷⁶

B. Comments and Discussion

46. AT&T filed the information requested in the NPRM relating to its service quality and network reliability. This information includes an independent audit prepared by the accounting firm of Coopers & Lybrand. AT&T also furnished additional information concerning

⁷³ AT&T Comments, Exhibit A at 4. Additional information regarding the computer errors was provided by AT&T. Ex parte from Agnes Cashman, AT&T, to Secretary, FCC, dated August 4, 1994.

⁷⁴ NPRM, 8 FCC Rcd at 5207.

⁷⁵ AT&T Comments at 27.

⁷⁶ NPRM, 8 FCC Rcd at 5207-08.

list of services included in Basket 1 shall be deleted and commercial services shall be added to the list of services AT&T shall exclude from its price cap baskets (See Appendix A).

51. IT IS FURTHER ORDERED that this Report and Order and the rule amendment adopted in this Order shall be effective 30 days after the publication of this rule change in the Federal Register.

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William F. Caton

William F. Caton
Acting Secretary

its EB&F reports in a series of ex parte filings. None of the other parties to the proceeding commented on this issue.

47. Based on the AT&T audit report and its ex parte filings, it appears that AT&T had made errors in its baseline EB&F Report and that the corrections undertaken by AT&T were reasonable. We find that AT&T's revisions to the EB&F data are acceptable and will not impair the purpose of the EB&F Reports, which is to provide a reliable measure of AT&T service quality and network reliability performance that is consistent over time. Statistical analysis of the changes in the EB&F Report's coverage arising from the elimination of calls to or from Canada and parts of the Caribbean, indicate that the change will have a de minimis effect on the number of equipment failures and blockages reported⁷⁷ because of the statistically insignificant number of calls to those areas in relation to the number of domestic calls completed by AT&T.⁷⁸ Based on the record developed in this proceeding, we conclude that the EB&F Reports, as revised by AT&T, provide a reliable and valuable tool for monitoring AT&T's service quality.

VI. CONCLUSION AND ORDERING CLAUSES

48. For the foregoing reasons, we conclude that it is in the public interest to remove commercial services from price cap regulation and to streamline regulation of these services. In addition, we expect that this decision will foster lower prices and expanded service offerings for customers of commercial services. Accordingly, we order these services removed from Basket 1 and adopt conforming changes to Sections 61.42(a)(1), (b)(1)(vi) and (2)(c), 47 C.F.R. §§ 61.42(a)(1) and (2)(c), as indicated in Appendix A, infra. AT&T is ordered to remove commercial services, as defined in this Order, from Basket 1 in a single filing effective no later than 30 days after publication of this Order in the Federal Register. As indicated above, we are not changing the productivity factor in the price cap formula. We also conclude that there is no basis for changing the current rules and policies governing both 800 directory assistance and analog private line services under price cap regulation. Finally, AT&T has responded to our concerns, as set out in the NPRM, regarding the accuracy of its EB&F Reports. We will, as indicated above, continue to review future EB&F Reports.

49. Accordingly, IT IS ORDERED that the petition to file reply comments out of time filed by the Federal Trade Commission IS GRANTED.

50. IT IS FURTHER ORDERED that, pursuant to Sections 4(i), 201-205, 303(r), and 403 of the Communications Act, 47 U.S.C. §§ 151(i), 201-205, 303(r), and 403, Section 61.42 of the Commission's Rules is amended as follows: references to small business services in the

⁷⁷ Ex partes from Charles L. Ward, AT&T, to the Secretary, FCC, dated June 14 & 24, 1994.

⁷⁸ Ex parte from Charles L. Ward, AT&T, to Secretary, FCC, dated June 24, 1994.

APPENDIX A

Part 61 of Title 47 of the Code of Federal Regulations is amended as follows:

PART 61 - TARIFFS

1. The authority citation for Part 61 continues to read as follows:

AUTHORITY: Sec. 4, Stat. 1066, as amended; 47 U.S.C. 154. Interpret or apply Sec. 203, 48 Stat. 1070; 47 U.S.C. 203.

2. In Section 61.42, paragraphs (a) (1) and (b) (1) are amended by removing the words "and small business" and paragraph (c) is amended by redesignating paragraph (c) (17) as paragraph (c) (18) and adding a new paragraph (c) (17) to read as follows:

Section 61.42 Price cap baskets and service categories.

* * * * *

(c) * * *

(17) Commercial services.

* * * * *